

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 ) No. 92R-1182-TL  
MARY J. OLSON )

For Appellant: Eduardo G. Sanchez  
Attorney at Law

For Respondent: David T. Gemmingen  
Tax Counsel

OPINION

This appeal is made pursuant to section 19057, subdivision (a),<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Mary J. Olson for refund of personal income tax in the amount of \$169,632 for the year 1990.

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<sup>1/</sup> Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The issue for determination is whether the conveyance of property securing a nonrecourse loan to the lender in lieu of foreclosure should properly be characterized as income from the sale or exchange of property or as discharge of indebtedness income where the amount of the loan exceeds the fair market value of the property.

Appellant and her former spouse, J. Donald Olson, were separated on August 29, 1988, and were subsequently divorced on August 22, 1991. During 1990, Mr. Olson owned a 91-percent interest in Guildhouse Consultants, Ltd. (the Partnership) and was its tax matters partner. On February 23, 1990, the Partnership owed \$14,478,333 on a nonrecourse note secured by property with a fair market value of \$10,532,529. The Partnership's adjusted basis in the property was \$8,842,485. On that day, the Partnership deeded the property to the lender in lieu of foreclosure. The amount of gain realized on this transaction was \$5,635,848; Mr. Olson's distributive share of this gain was \$5,127,627 (91 percent). Due to California's community property laws, appellant was allocated half of the gain (\$2,563,813) and, thus, owed \$151,635 in California income taxes therefrom. After appellant received her final distribution from the divorce, she paid the tax, plus interest, on September 3, 1991. On November 11, 1991, the appellant made a claim for refund; since respondent did not make a determination within the statutory six-month period, this appeal ensued.

Citing Commissioner v. Tufts, 461 U.S. 300 [75 L.Ed.2d 863] (1983), Gershkowitz v. Commissioner, 88 T.C. 984 (1987), Rev. Rul. 92-53, 1992-2 C.B. 48, and Private Letter Ruling 89-18-016 (Jan. 31, 1989), appellant claims the conveyance to the lender should be bifurcated. Hence, the Partnership should recognize gain on the sale or exchange of the property pursuant to Internal Revenue Code section 61(a)(3)<sup>2/</sup> to the extent the property's fair market value exceeded its adjusted basis; to the extent the amount of the nonrecourse note exceeded the property's fair market value, that gain should be treated as cancellation of indebtedness income under Internal Revenue Code section 61(a)(12). Moreover, appellant contends that since she was insolvent at the time, the insolvency exception is applicable, thus relieving her from income tax liability on the cancellation of indebtedness leg of the transaction. (See Rev. & Tax. Code, § 17131; I.R.C. § 108.) We find appellant's interpretation of the above-cited authorities to be erroneous and, therefore, sustain respondent's determination.

Tufts and Gershkowitz contain facts similar to those at bar, but this is where the analogy ends. Both of these cases stand for the proposition that the conveyance of mortgaged property in lieu of foreclosure should be treated as a sale, exchange, or other disposition of property. Thus, such a transaction should not be classified as income from the discharge of indebtedness, but as gains derived from dealings in property. (Commissioner v. Tufts, *supra*; Gershkowitz v. Commissioner, *supra*; Estate of Delman v. Commissioner, 73 T.C. 15 (1979).) Moreover, since the full amount of the nonrecourse liability is included in the basis calculation, it should also be included in the amount realized upon disposition. The fact that the amount of the loan exceeds the fair market value of the property is irrelevant. (Commissioner v. Tufts, *supra*, 461 U.S. at 307; Crane v. Commissioner, 331 U.S. 1 [91 L.Ed. 1301] (1947).)

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<sup>2/</sup> The definition of "gross income" for California personal income tax purposes is in conformity with its federal counterpart (I.R.C. § 61). (See Rev. & Tax. Code, § 17071.)

When a taxpayer sells or disposes of property encumbered by a nonrecourse obligation, the Commissioner properly requires him to include among the assets realized the outstanding amount of the obligation. The fair market value of the property is irrelevant to this calculation.

(Commissioner v. Tufts, supra, 461 U.S. at 317.)

Therefore, the amount recognized in this conveyance is equal to the amount of the nonrecourse loan less the adjusted basis of the property. (See Gershkowitz v. Commissioner, supra, 88 T.C. at 1016; Rev. & Tax. Code, § 18031; I.R.C. § 1001; Treas. Reg. § 1.1001-2(a)(1).)

Likewise, appellant's reliance on Revenue Ruling 92-53 and Private Letter Ruling 89-18-016 is misplaced. These two rulings deal with situations where there is a discharge of indebtedness. As stated above, the case at bar does not involve any discharge of indebtedness, but a disposition of property in lieu of foreclosure.

Finally, appellant cites Justice O'Connor's concurrence in Tufts as authority for bifurcating the conveyance. While Justice O'Connor's position is eloquently stated, it is not the view of the other eight Justices and, thus, not the law of the land.<sup>3/</sup>

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<sup>3/</sup> Based on the foregoing, we need not address respondent's alternative contention that even if this conveyance can be bifurcated, appellant's calculations for purposes of the insolvency exception are wrong.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Mary J. Olson for refund of personal income tax in the amount of \$169,632 for the year 1990 be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of July, 1994, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Fong, Mr. Dronenburg, and Ms. Scott present.

Brad J. Sherman\_\_\_\_\_, Chairman

Matthew K. Fong\_\_\_\_\_, Member

Ernest J. Dronenburg, Jr.\_\_\_\_\_, Member

Winnie Scott\*\_\_\_\_\_, Member

\_\_\_\_\_, Member

\*For Gray Davis, per Government Code section 7.9.

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